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India: Import Policies and Practices

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INDIA: IMPORT POLICIES AND PRACTICES

SUMMARY AND CONCLUSIONS

1. To preserve scarce foreign exchange and encourage domestic production, New Delhi probably will continue tightening its direct controls over imports. Major features of this control system are

- allocation of foreign exchange among importers under an ambiguous system of priorities,
- a complicated licensing system requiring that imports be vital to the economy and unavailable domestically (comparative costs are not considered), and
- nationalized trade for principal imports.

The implementation of these policies has given rise to a lumbering corrupt bureaucracy, excessive import delays, elimination of foreign competition, restriction of competition among domestic firms, and overconstruction of industrial capacity.

2. Nonetheless, New Delhi has been generally successful in achieving the major goals of its import controls. Dependence on imports has declined significantly; the import structure has shifted from finished manufactures to raw materials and components; and, in many important areas, domestic production has been substituted for imports. For these gains, India has paid dearly in terms of

- industrial growth impeded by import shortages,
- export growth retarded as sheltered domestic industry became less competitive,
- essential imports postponed in the face of rising world prices, and
- dislocation of trade and market channels through smuggling and black marketeering.

Such diseconomies apparently will be tolerated in favor of rigid import controls.

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Note: Comments and queries regarding this publication are welcomed. They may be directed to [redacted] of the Office of Economic Research, Code 143, Extension 7892.

DISCUSSION

Introduction

3. New Delhi's import policy is based on a decision, dating from the early 1950s, to seek maximum economic self-sufficiency by substituting local products for imports. Administrative controls implementing this policy have proliferated despite obvious diseconomies. This publication describes the import control system, assesses the nation's progress in reducing its reliance on imports, discusses economic costs of the import substitution program, and offers some observations on India's short-term trade outlook.

The Import Control System

4. India has employed import controls for about two decades. Their stated objective is to promote maximum independence from foreign sources of supply by limiting imports to products for which demand exceeds domestic production capabilities. Import controls are also used to ensure that the nation's limited foreign exchange is allocated in accordance with national priorities. With foreign exchange usually in short supply, import controls -- a few brief periods of liberalization excepted -- have been successively tightened. No mechanism has been provided for considering the comparative cost of imports versus domestic products. Although the import control system has received considerable criticism, few alternatives have been offered. Even when the more blatant abuses have been pointed out, New Delhi has been slow to take corrective action.

5. New Delhi controls imports by banning many foreign products and imposing complex licensing procedures on permissible imports. Annual allocations of foreign exchange for imports are assigned in diverse ways. Major commodity categories such as food, fertilizers, petroleum products, and defense normally get top priority. Detailed allocations (by commodity) channel exchange to industries, to various schemes (e.g., the Export Promotion Scheme giving export industries a high priority for imported materials), and to individual firms.

6. Import licenses are issued by several authorities. The two principal licensing criteria are essentiality and indigenous non-availability. An import license is issued only after the proper government agencies certify that the import is "essential" as an input to the Indian economy and that there is no domestic production of the import requested. If the item is produced domestically, import is not permitted regardless of cost, quality, or delivery time. License applications must also specify source from which the imports may be obtained so that preference can be given countries with whom India has aid or bilateral trade agreements.

Impact of Import Policies

7. Development of Indian production of goods formerly imported has reduced dependence on imports in many important industrial and agricultural sectors.[1] In 1960-67,[2] the import component of the domestic market for manufactured goods declined from 16% to less than 11% (see Table 1). When industrial raw-material inputs -- such as raw cotton and crude petroleum -- were included, figures for overall dependence on imports declined from 21% to 15% for the same period. Capital goods industries -- particularly basic metals, metal products, transport equipment, and electrical machinery -- accounted for most of the decline. Moreover, components and parts often were substituted for finished products.[3] These trends were less marked in intermediate goods, such as paper, rubber, and petroleum products and chemicals, where aggregate imports supplied 21% of the market in 1960 and 19% in 1965. The market share of imported intermediate goods probably increased during the next two years because of the rapid increase in fertilizer imports and lack of progress toward indigenous production in the rest of the chemical industry. In consumer goods industries, the import substitution program was pursued vigorously during the 1950s and was almost complete by 1965, when only 0.5% of the market was met by imports.

8. A promising shift in the structure of imports also has taken place. Imports of petroleum products, transport equipment, and non-ferrous metals have grown more slowly than total imports because of the restrictions encouraging domestic production. Other items have shown significant reductions only in recent years. Non-electrical machinery imports, for example, have declined 34% since 1966. Some products -- notably foodstuffs and iron and steel -- have oscillated because of irregularity in domestic output and demand. Imports of fertilizers, pesticides, and improved seeds have increased to support accelerated effort on domestic agriculture. After peaking at 34% of imports in 1966 during the second consecutive year of serious drought, grain imports declined as weather improved and high yielding wheat strains were introduced. The raw material component of imports declined from 25% in 1950 to 11% in 1965 but increased again to 20% in 1971 as domestic cotton production lagged and crude petroleum needs expanded (see Table 2). Since 1966, cotton imports have doubled because of heightened domestic competition for land from wheat. Crude oil imports rose sharply during the past five years as domestic refining capacity increased and imports of finished petroleum products declined.

1. This discussion excludes imports of military equipment, which do not appear in Indian trade data.
2. Data on import content in domestic supplies for later years are inadequate for aggregate analysis.
3. E.g., in the non-electrical machinery category, the proportion of components rose from 50% to 58%; in electrical machinery, from 25% to 49%; and in transport equipment, from 62% to 74%.

Table 1

India: Imports[1] of Finished Products as a Percent of Total Supply

	1960[2]	1963	1964	1965	1966	1967
Consumer goods industries	1.1	0.6	0.5	0.5	0.6	0.5
Food manufacturing	0.5	0.7	0.5	0.5	1.0	0.9
Textiles	1.7	1.0	1.0	0.6	0.4	0.3
Intermediate goods industries	20.8	22.9	19.4	18.8	N.A.	N.A.
Paper and paper products	20.7	16.5	16.5	16.9	16.2	13.3
Rubber products	0.6	2.7	2.0	1.2	1.2	1.1
Chemicals	19.1	26.2	23.3	23.7	25.6	31.3
Petroleum and petroleum products	40.1	50.4	41.6	36.3	40.6	23.8
Capital goods industries	37.3	29.1	28.3	25.8	20.7	19.7
Non-metallic minerals	4.6	2.6	3.0	2.4	3.2	4.1
Basic metals	35.2	20.3	19.2	18.5	13.3	14.7
Metal products	16.5	7.4	8.1	7.3	4.7	2.7
Non-electrical machinery	71.7	59.5	60.2	62.4	55.5	52.2
Electrical machinery	43.7	41.8	39.9	34.4	27.2	22.3
Transport equipment	23.2	22.1	20.5	15.5	11.1	14.3
All industries	16.1	14.3	13.3	12.8	10.5	10.7

1. C.i.f.
2. Fiscal years, starting on 1 April of the stated year, are used throughout this table.

9. The ratio of imports to GNP also reflects decreasing import dependence, declining from 6.4% in 1965 to 4.0% in 1972. Imports reached a peak in 1965 at about $3 billion – exceeding export earnings by 75% – after increasing at an average annual rate of 5.6% since 1948 (see Table 3). After 1965, increased debt service payments and reduced foreign aid forced a tightening of import controls in India's effort to narrow the staggering trade deficit. The success of that effort is reflected in a 29% reduction in imports during the next four years despite moderate domestic inflation. A 12% increase in imports in 1971 was due mainly to direct imports for Bangladesh refugees. With their exodus in 1972, imports resumed their downward trend, declining by 2%.

10. Foreign exchange pressures were further relieved by shifting imports to countries funding aid programs and those not demanding payment in hard currencies. In the early years of independence, the United States, the United Kingdom, and other Commonwealth countries were predominant suppliers (see Table 4). With the advent of large-scale aid in the late 1950s, imports from the United States, European Common Market countries, the USSR and East European countries, and Japan grew at the

Table 2

India: Distribution of Imports

Percent

	1950[1]	1955	1960	1965	1970	1971
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Food	**19.2**	**10.0**	**19.5**	**25.3**	**19.0**	**13.5**
Grains	13.8	2.6	16.2	21.9	13.0	5.7
Cashew nuts	0.5	0.7	0.8	1.1	1.8	1.5
Oils and fats	0.7	1.1	0.4	1.1	2.3	2.6
Other foods	4.2	5.6	2.1	1.2	1.9	3.7
Raw materials	**25.2**	**19.0**	**15.4**	**11.1**	**18.7**	**19.9**
Raw cotton	17.4	8.5	7.3	3.3	6.1	6.2
Crude petroleum	3.1	1.4	1.6	2.5	6.5	8.2
Other raw materials	4.7	9.1	6.5	5.3	6.1	5.5
Manufactured goods	**54.7**	**70.1**	**64.5**	**61.2**	**60.9**	**65.7**
Paper and paper products	1.8	2.4	1.1	0.9	1.5	1.9
Iron and steel	3.3	9.8	10.9	6.9	9.0	13.1
Copper	1.5	1.3	2.0	2.4	3.7	2.8
Other non-ferrous metals	3.4	2.4	2.2	2.5	3.6	2.8
Electrical machinery	2.0	2.9	5.1	6.2	4.3	5.6
Non-electrical machinery	12.1	14.2	18.1	23.6	15.8	14.8
Transport equipment	6.1	9.0	6.5	5.0	4.1	5.6
Petroleum products	6.3	5.1	4.6	2.4	1.8	2.6
Basic chemicals	1.6	3.2	3.5	2.5	4.1	4.0
Fertilizers	2.1	0.4	0.8	2.8	3.8	4.5
Other chemicals	4.5	5.5	3.3	2.1	3.9	3.6
Other manufactures	10.0	13.9	6.4	3.9	5.3	4.4
Unclassified	**0.9**	**0.9**	**0.6**	**2.4**	**1.4**	**0.9**

1. Fiscal years, starting on 1 April of the stated year, are used throughout this table.

expense of the United Kingdom and many African and Asian countries. In addition, bilateral trade agreements providing for settlement in rupees were concluded with the USSR and all East European countries except Albania. By 1965, net aid flows began declining rapidly. US exports to India fell after 1966, largely because of slackened PL-480 food shipments. By 1968 a substantial redirection of imports was under way. Declining aid deliveries from the USSR and Eastern Europe reduced their share of Indian imports from 17% in 1969 to 11% in 1971. Meanwhile, imports from Iran, Japan, Canada, and many African and Asian nations increased.

11. Despite substantial gains in import substitution, India remains heavily dependent on imports of several major categories of commodities,

Table 3

India: Balance of Trade

Million US $

Fiscal Year[1]	Exports	Imports	Trade Balance
1948	900	1,174	-274
1949	1,020	1,297	-277
1950	1,275	1,221	54
1951	1,550	2,039	-489
1952	1,213	1,474	-261
1953	1,115	1,282	-167
1954	1,245	1,379	-134
1955	1,253	1,426	-173
1956	1,270	1,766	-496
1957	1,334	2,177	-843
1958	1,220	1,904	-684
1959	1,344	2,018	-674
1960	1,386	2,356	-970
1961	1,376	2,290	-914
1962	1,425	2,377	-952
1963	1,658	2,569	-911
1964	1,714	2,834	-1,120
1965	1,692	2,959	-1,267
1966	1,541	2,771	-1,230
1967	1,598	2,677	-1,079
1968	1,810	2,545	-735
1969	1,884	2,109	-225
1970	2,047[2]	2,179	-132
1971	2,106	2,436	-330
1972	2,605	2,396	209

1. Starting on 1 April of the stated year.
2. Overstated by about $100 million because of a definitional change effected in November 1970.

including petroleum, heavy machinery, aircraft, basic metals, and chemicals. Decreasing reliance on imports of petroleum and most basic metals appears unlikely. In 1970, 63% of India's crude petroleum was imported, and demand has been outstripping domestic discoveries. Among basic metals, domestic production predominates only for aluminum and iron and steel. Even for these products, the import share of total supply increased substantially from 1969 to 1971: for aluminum, from 2% to 10%; for iron and steel, from 8% to 23%. In 1971, imports provided the major share of supplies of a number of other metals: e.g., copper 85%; zinc 80%; lead 96%; nickel, tin, and antimony 100%. India is nearly self-sufficient in

Table 4

India: Sources of Imports

Percent

	1950[1]	1955	1960	1965	1970	1971
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Africa	**11.8**	**10.0**	**5.0**	**3.5**	**10.4**	**8.0**
Of which:						
UAR	5.8	3.4	1.5	1.4	2.4	1.8
Western Hemisphere	**24.5**	**15.3**	**31.8**	**40.6**	**35.9**	**29.7**
Of which:						
United States	20.7	13.2	29.9	38.2	27.7	23.1
Canada	3.7	1.0	1.8	2.2	7.2	6.2
Asia and Oceania	**26.9**	**25.3**	**18.4**	**16.8**	**18.4**	**23.5**
Of which:						
Iran	6.5	2.1	2.7	2.4	5.6	7.0
Japan	1.8	4.9	5.6	5.7	5.1	8.9
Australia	5.9	2.0	1.6	1.7	2.2	1.6
USSR and Eastern Europe	**0.6**	**1.6**	**4.0**	**11.2**	**13.9**	**11.2**
Of which:						
USSR	0	0.9	1.5	5.9	6.5	4.5
Western Europe	**36.2**	**47.8**	**40.8**	**27.9**	**21.4**	**27.6**
Of which:						
United Kingdom	23.1	25.5	19.9	10.7	7.8	12.0
West Germany	1.9	8.9	11.2	9.8	6.6	6.9

1. Fiscal years, starting on 1 April of the stated year, are used throughout this table.

agricultural commodities in good years but requires large imports when the monsoon rains fail. As a result of inadequate monsoon rains in 1972, imports of raw cotton, edible oil, and foodgrains rose again in 1973.

Economic Costs of Import Controls

12. Foreign exchange allocation among alternative claimants and uses in a direct control system would seem to demand a well-defined set of criteria and a system of priorities. The Indian bureaucracy administering import allocations has lacked such guidance. Industrial allocations have perforce been based on vague notions of equity and guidelines, such as installed capacity, size of labor force, or past allocations. Furthermore, agencies certifying the non-availability of domestic products frequently lack adequate information on the production and distribution capabilities of indigenous suppliers. Although this situation sometimes results in unjustified imports, more often fully justified import applications are denied.

13. The opportunity for error and obstruction is enhanced by a complex bureaucracy that requires several certifications on each application. Delay is the rule. Applications unaccompanied by graft payments may be completely ignored. A 1966 study reported that the time required to process import applications for machinery and heavy equipment averaged 14 months. Many industrial managers spent more than half of their time dealing with the government bureaucracy. The efficiency of industrial plants using imported supplies has been severely hampered by this situation.

14. Quantitative restriction of imports has reduced domestic industrial production and has tended to push price levels above world prices. The protection afforded by quantitative import restrictions is unpredictable and varies with changes in domestic supply and demand. A recent study showed that effective rates of protection from quantitative restrictions often exceeded an ***ad valorem*** tariff of several hundred percent. The inability of the new import substitution industries to develop to the point where they can compete in world markets probably costs India more in forgone exchange earnings than is conserved by import restrictions. Furthermore, the development of competitive native industries may offer a surer route to long-term economic independence. Indian policy makers, however, have so far remained wedded to the principle that strict import control is the answer to balance-of-payments problems.

15. Inordinate administrative delays and import premiums have fostered smuggling and other means of circumventing the control system. Counterfeit import licenses, false declarations, and fraudulently obtained certificates abound. Specialized black markets facilitate dealings in "non-transferable" imports and import licenses. These activities undermine the objectives of the control system.

16. India's import policy has severely restricted competition, disrupting normal industrial growth and resource allocation. Absolute protection from foreign competition is extended to almost all industries regardless of cost, efficiency, or comparative advantage. The practice of allocating import licenses on a fair share basis tends to freeze the distribution of market shares and to preclude the entry of new firms. Under these conditions, expansion of production may be influenced by unusual considerations. Indian studies reveal that use of installed capacity to determine import allocations has led to wanton overbuilding of capacity, sometimes in the face of underutilization of the existing plant.

17. New Delhi's failure to adjust import allocations in the face of crucial shortages of industrial inputs has been a major cause of the industrial recession that has plagued India for more than six years. Although imminent shortages of essential raw materials and production supplies are often

predictable -- e.g., the failure of a cotton crop or insufficient domestic crude oil production -- New Delhi has steadfastly declined anticipatory increases in import allocations. Thus, avoidable slowdowns in materials-short industries have been common. Even after increased allocations are finally authorized, the alleviation of the situation is delayed by the usual red tape and shipping problems. For example, domestic demand for finished steel, growing by nearly 9% annually, outstripped domestic production in 1969, but New Delhi refused to adjust steel import allocations until one year later when slowdowns hit steel-consuming industries. Reallocations reduced the gap between demand and supply by only a third. It has since widened, increasing -- by even the most optimistic estimates -- in 1973 to almost 1 million tons, some 15% of domestic requirements.

18. Similarly, New Delhi's procrastination in adjusting to the failure of its 1972 crops proved exceptionally costly. Grain shortages were predictable by July, but the first foreign purchases were not made until December. In the interval, the price of wheat rose from \$70 to \$100 a ton. Additional wheat purchases were required in June and July 1973 at prices up to \$145 a ton. The delayed purchases wasted between \$50 million and \$100 million in scarce foreign exchange.

Prospects

19. New Delhi probably will continue its present import policy of increasing control over foreign trade. Despite opposition from some elements of the business community, Prime Minister Gandhi appears more concerned with her socialist image than economic efficiency. She placates left-wing Congress Party elements with showcase announcements of increased government control over the economy. Control over imports, therefore, is likely to increase despite occasional relaxation of controls on specific products. The growth of state trading corporations will almost certainly be encouraged by further restrictions on private imports.

20. The principal economic inducement to import controls is New Delhi's concern over India's chronically troublesome foreign exchange position. The accumulation during the past four years of an additional \$720 million in foreign exchange is viewed as a temporary phenomenon. Last year's export expansion, due largely to emergency relief to Dacca and India's filling of the gap created by the disruption of Bangladesh's jute goods industry, is unlikely to recur, because of that country's economic recovery. Other sources of foreign exchange remain uncertain in the face of a certain increase in expenditure for petroleum imports. Net aid receipts have declined sharply since 1966 as debt repayments have risen. Moreover, new foreign investment has declined as private foreign investors have come under increasing government pressure. The import control system is viewed by

Indian officials as an effective weapon against gross imbalances in India's foreign accounts. Actually, it has been a major contributor to imbalances by fostering high-cost industries that depend on imports but are unable to compete in world export markets.

21. Finally, considerable structural resistance remains to any drastic change in the control system. In more than two decades of operation, a large government bureaucracy has been developed to administer import controls. Many domestic industries have developed under the bureaucratic shelter and cannot survive without it.

22. Present import policies will continue to produce shortages of raw materials, components, and capital equipment. Shortages are likely to become more acute if substantial expenditures for imported foodgrains are needed in the next few years. This year's crop appears good, but historically agricultural production falters periodically – one year out of four – i.e., when summer monsoon rains are poor. Crude petroleum imports probably will double in total outlay. Imports of other goods will remain especially vulnerable until food stocks are rebuilt. Despite a compelling need to hedge against this eventuality by rebuilding foodgrain stocks depleted last winter, New Delhi is not likely to release foreign exchange for stockpiling while other serious import shortages exist. Chances are slim that domestic production alone can rebuild foodgrain stocks sufficiently to carry India through the next poor monsoon without massive imports.

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